No. 10,644

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

LORIN A. CRANSON, *Appellant,* vs. THE UNITED STATES OF AMERICA, *Appellee.*	}

APPELLANT'S REPLY BRIEF.

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I.

THE GOVERNMENT'S FIRST ARGUMENT, THAT THE OPERATING DEFICITS OF THE SUBSIDIARIES DID NOT DIMINISH THE EARNINGS OR PROFITS OF HONOLULU AVAILABLE FOR DIVIDENDS, IS BASED ON A MISCONCEPTION OF THE STATUTE.

The major portion of that part of the argument in appellant's opening brief relating to the absorption by Honolulu of the operating deficits of its subsidiaries was devoted to the proposition that no logical distinction can be drawn between the transfer of corporate earnings in a nontaxable reorganization and the transfer of operating deficits. The Government in its brief makes no attempt to refute this proposition, and it must therefore be presumed that the point is conceded and that it is admitted it is illogical for the Government to rule on the one hand that

corporate earnings are transferred in nontaxable reorganizations, as the Treasury Regulations provide, and on the other hand to deny, as it does in the instant case, that operating deficits must receive the same treatment.

We wish to emphasize at this point that not only is the Government's position illogical but it is inequitable as well, since it results in taxing as income that which in fact is not income. It is admitted that the dividends received by the stockholders of Honolulu in 1936 were *actually* distributions of capital.[1] Since the stockholders were actually receiving a return of their capital and not receiving income, they should not be subjected to tax unless the law clearly requires such a result. Such a result will be avoided if the Court holds that the doctrine of the *Sansome* case, i.e., that nontaxable reorganizations do not break the continuity of the corporate life as a continuing venture, applies to the transfer of operating deficits as well as to transfer of earnings or profits.

The Government's main argument in support of its illogical and inequitable position may be summarized as follows: Subsections (c) and (h) of section 115 of the Revenue Act of 1936 provide for the transfer of corporate earnings in nontaxable reorganizations (Br.

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[1]It is stipulated that Honolulu's earnings available for dividends on January 1, 1936, amounted to $139,631.26, that Honolulu's earnings during 1936, before giving any effect to the liquidation of the subsidiaries, amounted to $931,553.82 (R. 38), and that Honolulu realized a loss of $1,225,908.63 upon the liquidation of the subsidiaries in 1936 (R. 33). Since the loss exceeded the total earnings available, all dividends in 1936 were actually distributions of capital, except possibly to the small extent indicated in the footnote on page 6 of our opening brief.

p. 8, lines 5 and 6); the statute does not provide for the transfer of an operating deficit (Br. p. 8, lines 7-10); if the language of the statute is plain, it is the duty of the courts to enforce the law as written (Br. pp. 10-11); from which it is concluded that earnings alone are to be transferred and operating deficits not transferred. This argument is unsound. The fallacy lies in the fact that the major premise is false; subsections (c) and (h) of section 115 do *not* provide for the transfer of corporate earnings in a nontaxable reorganization.

(a) Subsections (c) and (h) of section 115, Revenue Act of 1936, do not provide for the transfer of corporate earnings in nontaxable reorganizations, and have no application to the instant case.

Section 115(c) is set forth in full in the appendix. Omitting the portions of this section relating to partial liquidation and defining "complete liquidation", neither of which can have any possible application, the remaining portion of this section of the statute reads as follows:

> "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as a part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112."

The foregoing section of the statute relates to the taxation of liquidating dividends to the recipient.

There is obviously nothing in this section of the statute which remotely relates to the transfer of the earnings or profits of the predecessor corporation to the successor corporation in a nontaxable reorganization.

Section 115(h) has likewise no bearing whatever on the transfer of corporate earnings in nontaxable reorganizations. This section of the statute reads in full as follows:

> "(h) **Effect on earnings and profits of distributions of stock.**—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—
>
> (1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or
>
> (2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.
>
> As used in this subsection the term 'stock or securities' includes rights to acquire stock or securities."

Section 115(h) merely provides that the distribution by a corporation of its own stock or securities, or stock or securities of another corporation, shall

not be considered a distribution of earnings or profits if the distribution is not taxable to the recipient. The purpose of this section was to prevent a corporation from making a tax-free distribution to its stockholders of stock or securities, as in a merger or consolidation, and at the same time contend that it had reduced its earnings available for dividends.[2] It obviously has no bearing in the instant case, since neither the subsidiaries nor Honolulu made any distribution of stock or securities.

In referring to the doctrine of the *Sansome* and *Kauffman* cases, the Government makes the statement: "This doctrine was embodied in Section 115 (c) (h) of the Revenue Act of 1936." (Br. p. 8.) As we have seen, this statement is not correct and since it constitutes the major premise of the Government's argument that the doctrine of the *Sansome* case does not apply to operating deficits, the entire argument falls with its major premise.

(b) Failure of the statute to provide for the transfer of operating deficits is therefore of no significance.

There is no section of the Revenue Acts or the Internal Revenue Code which incorporates the doctrine of the Sansome Rule or otherwise deals with the transfer of corporate earnings in nontaxable reorganizations. The statements on page 8 of the Government's brief, and again on page 10, that the Revenue Acts do

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[2]Section 115(h) appeared in its original form as section 203(g) of the Revenue Act of 1924. The reasons for its enactment appear on page 9 of a statement prepared for the use of the Senate Committee on Finance (68th Congress, 1st Session), entitled "Statement of the Changes made in the Revenue Act of 1921 by H.R. 6715 and the Reasons Therefor."

not provide for the transfer of an operating deficit in corporate reorganizations, thus loses all significance, since the Revenue Acts likewise do not provide for the transfer of corporate earnings.

The references to the Sansome Rule contained in the extracts from the reports of the Senate Finance Committee contained on pages 8 to 10 of the Government's brief do not support the Government's position. The extract commencing on page 8 was written in explanation of section 115(h) of the Revenue Act of 1936, which, as we have heretofore pointed out (supra, pp. 4-5), has no bearing whatever on the questions involved in the instant case. The Committee Report explains that under section 115(h) earnings or profits are not reduced by a distribution of corporate securities in nontaxable reorganizations, adding the comment that such earnings remain available for distribution by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon the reorganization. The latter part of this statement is a recognition of the Sansome Rule, but can in no sense be taken as even implying that the rule does not apply equally to operating deficits. This is so because corporations with operating deficits are obviously not affected by section 115(h), since such corporations have no earned surplus and this section was intended solely to prevent corporations from claiming that their earned surplus available for dividends had been decreased by distributions of stock or securities which were not taxable to the recipient.

The extract from the report of the Senate Finance

Committee commencing on page 9 of the Government's brief was written in explanation of section 501 of the Second Revenue Act of 1940, which relates to the *deduction of the loss* sustained by Honolulu upon the liquidation of its subsidiaries (this being the section which appellant contends is unconstitutional if applied in the instant case), and has no bearing upon the *transfer of the operating deficits* of the subsidiaries. The doctrine of the Sansome Rule is again referred to in this extract, but this cannot be taken as denying the application of the rule to operating deficits. In fact the last sentence of the extract, stating in part that the requirement of section 501 to the effect that there shall be no *decrease* in earnings and profits by reason of an unrecognized *loss* is but another aspect of the Sansome Rule, is at least an implication, if not a direct statement, that the rule *does* apply to operating deficits. To reduce earnings available for dividends by the loss realized, though not recognized for income tax purposes, on the liquidation of the subsidiaries, and also to allow the transfer of their operating deficits, would give a double effect to the same loss. Therefore the provision that the unrecognized loss does *not* reduce earnings can be correctly described as but another aspect of the Sansome Rule *only if the rule includes the transfer of operating deficits.*

In any event, no significance can be attached to the fact that a Committee of Congress in setting forth the doctrine of the *Sansome* case confines its statement to the doctrine as enunciated in the decided cases. The decided cases have dealt solely with earnings or profits and it is natural that the Committee report in re-

ferring to this doctrine should state it as set forth in those cases. Furthermore, the Committee's statement of the doctrine is not entitled to any weight, since, as we have stated, there is no section of the Revenue Acts which deals with this subject, and Committee reports are entitled to weight only when resorted to as an aid in statutory construction.

The same observations apply to the Treasury Regulations. The fact that these Regulations may contain a statement of the doctrine of the *Sansome* case, in so far as that doctrine has been enunciated by the courts, is of no significance in determining whether the doctrine also includes matters not yet covered by court decisions. The Government argues (Br. pp. 11-12) that the reenactment of subsections (c) and (h) of section 115 "without any substantial changes that would affect this question" must be given the effect of reading the statement contained in the Regulations into the statute. As we have seen (supra, pp. 3-5) subsections (c) and (h) of section 115 have no relation whatever to the doctrine of the *Sansome* case, and accordingly their reenactment without substantial change cannot possibly be considered an approval of the doctrine of that case as set forth in the Regulations.

One further point requires mention on this phase of the Government's argument. On page 11 of the Government's brief, it is argued that a decision in appellant's favor would amount in substance to the granting of an exemption from income tax to the stockholders of Honolulu Oil Corporation and cases are cited in support of the proposition that exemptions

from taxation are never lightly to be inferred and must be granted in plain terms. Of course, the stockholders are not claiming exemption from taxation but are claiming that the dividends paid by Honolulu were to a large extent capital distributions and therefore not income and not subject to tax.

Included in the cases cited on page 11, relating to exemption from taxation, the Government cites *Co-operative Oil Ass'n v. Commissioner,* 115 Fed. (2d) 666 (C.C.A. 9). This case does not relate to exemption from taxation but stands for the proposition that deductions from gross income in the determination of statutory net income subject to tax are statutory privileges allowed as a matter of grace and that a taxpayer seeking a deduction must find statutory warrant therefor. The Government advanced such an argument in the Court below and cited this case to support it, but has abandoned the argument here. Appellant is obviously not seeking a deduction from gross income but is contending that certain distributions received from Honolulu Oil Corporation are not income as defined by the statute but are capital distributions. Nor is it contended that Honolulu is entitled to a deduction from gross income. Statutory deductions apply only in the determination of statutory net income subject to tax and have no application to the determination of earnings available for dividends. Since the Government has abandoned the argument that appellant is seeking a deduction not provided for by statute, it erred in citing the *Co-operative Oil Ass'n* case.

It also erred in stating our contention to be that "the words 'earnings and profits' as used in the statute

* * * should be interpreted to include 'operating deficits' " (Br. p. 15). We are not making any contention with respect to the meaning of any statutory provision. Here again the Government seems to persist in the error that the Sansome Rule is a statutory provision.

II.

THE GOVERNMENT ERRS IN ASSUMING THAT IF THE OPERATING DEFICITS OF THE SUBSIDIARIES ARE ABSORBED BY HONOLULU THEY WILL NOT REDUCE THE EARNINGS OR PROFITS OF THE TAXABLE YEAR.

The Government advances the argument (Br. pp. 12-14) that if the Court should hold that the Sansome Rule operates not only with respect to earnings or profits but likewise where operating deficits are involved, then the absorption of the operating deficits of the subsidiaries in 1936 will not reduce Honolulu's earnings for 1936. This argument is based on the assumption that section 115(a) of the Act of 1936 would prevent such a reduction. This section of the statute reads in full as follows:

> "(a) **Definition of Dividend.**—The term 'dividend' when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), with-

out regard to the amount of the earnings and profits at the time the distribution was made."

The portion of this section relied upon by the Government is that part defining a dividend to include any distribution "out of the earnings or profits of the taxable year". These words do not limit in any manner the *determination* of the earnings or profits of the taxable year, but merely state that any distribution therefrom constitutes a taxable dividend. If the loss actually realized by Honolulu on the liquidation of its subsidiaries in 1936 reduced its earnings available for dividends (as it would were it not for the retroactive provisions of section 501 of the Second Revenue Act of 1940 discussed elsewhere), it is clear that this loss, in the same manner as any other loss or deduction, would reduce Honolulu's earnings for 1936 available for dividends. If the Court should hold that the operating deficits of the subsidiaries are absorbed by Honolulu, then the loss on liquidation should of course not be allowed to reduce the earnings of Honolulu, since this would be giving a double effect to the same loss. Under such circumstances there could be no objection to the retroactive application of section 501 of the Second Revenue Act of 1940, which was apparently designed to prevent this double effect, and which would then operate in an equitable manner. If, then, the Court should hold that the operating deficits of the subsidiaries are absorbed by Honolulu, it is apparent that they would take the place of the loss on liquidation otherwise allowable as a reduction of the earnings of Honolulu. Since the loss on liquidation would, as we have seen, obviously reduce the earnings of

Honolulu for 1936, it is difficult to understand the Government's assumption that the transfer of the operating deficits would not have the same effect.

All 1936 transactions necessarily affect earnings for 1936, the balance of the profit or loss, as the case may be, at the end of the year being transferred to the earned surplus account. In order to demonstrate the fallacy of the Government's assumption that the operating deficits of the subsidaries, *even though absorbed by Honolulu,* do not reduce its earnings for 1936, let us assume for the moment that this assumption is correct. If the earnings for 1936 are not reduced, the only possible alternative is that the earnings of Honolulu for prior years in which the losses were sustained by the subsidiaries must be reduced, since otherwise there would be no reduction whatever and the operating deficits could not have been absorbed by Honolulu. But taxes have been paid by the stockholders of Honolulu on these prior annual earnings without taking the annual operating deficits of the subsidiaries into account. The stockholders could not have avoided the payment of these taxes because to take the deficits of the subsidiaries into account would require a disregard of the separate corporate entities of the subsidiaries—a result which is not supported by any authority. Thus the Government is arguing for the proposition that the stockholders must pay taxes on the annual dividends for prior years without taking into account the losses of the subsidiaries, and at the same time that the earnings for 1936 are not reduced by these losses when transferred to the parent corporation, so that the stockholders *never* receive the

benefit of the reduction in earnings.

The error in the Government's assumption becomes more readily apparent if it be assumed that the subsidiaries had earnings rather than operating deficits. Suppose, for example, that Honolulu had incorporated a subsidiary in 1936, and that this subsidiary had earnings of $100,000 a year for the years 1936, 1937, 1938 and 1939. Assume that Honolulu had an operating deficit in the amount of $500,000 at the beginning of 1936, had yearly earnings of $1,000,000, and declared dividends of $1,100,000, in each of these years. Since the dividends of Honolulu in each of these years exceeded its earnings by $100,000, it follows that for this period of four years the stockholders of Honolulu will have received total capital distributions in the amount of $400,000. Assume further that in January, 1940, the subsidiary, which has an earned surplus of $400,000, liquidates, and that Honolulu has earnings of $1,000,000 in 1940, not taking into account the earned surplus of the subsidiary in the amount of $400,000 which was transferred to Honolulu under the Sansome Rule. Honolulu then declares total dividends of $1,400,000 in 1940. It will be of assistance to tabulate the foregoing figures as follows:

	HONOLULU			SUBSIDIARY
Year	Earnings	Dividends	Capital Distributions	Earnings
12/31/35	$ *500,000*			
1936	1,000,000	$1,100,000	$100,000	$100,000
1937	1,000,000	1,100,000	100,000	100,000
1938	1,000,000	1,100,000	100,000	100,000
1939	1,000,000	1,100,000	100,000	100,000
1940	1,000,000	1,400,000		

Since under the doctrine of the *Sansome* case the subsidiary's earnings in the amount of $400,000 had been transferred to Honolulu in 1940, it seems apparent that Honolulu's earnings for that year will be $1,400,000 and not $1,000,000 as the Government assumes. (This certainly would be the result if the subsidiary's earnings had been transferred by the declaration of a dividend immediately prior to liquidation.) But let us suppose for the moment that the Government is correct and that the transfer of the subsidiary's earnings did not increase Honolulu's earnings for 1940. In such case the stockholders of Honolulu, having received distributions of $1,400,000 in 1940, which according to the assumption exceeded the available earnings by $400,000, will have received further capital distributions in the amount of $400,000. Since they had previously received capital distributions for the years 1936 to 1939, inclusive, in the amount of $400,000, their total capital distributions would thus be $800,000. This is obviously erroneous, since Honolulu and its subsidiary combined earned during the five years 1936 to 1940, inclusive, a total of $5,400,000, and distributed to Honolulu's stockholders $5,800,000. Thus the total capital distributions are only $400,000. The Government could not correct this erroneous result by going back to the years 1936 to 1939 and disallowing the capital distributions of $100,000 in each of these years (which incidentally might be barred by the statute of limitations), because to contend that the earnings of the subsidiary in the amount of $100,000 in each year were available for

dividends by Honolulu disregards the separate corporate entities, which, as we have stated, is not supported by any authority.

It seems apparent, therefore, that the liquidation of a subsidiary and the transfer of its earnings to the parent corporation results in increasing the earnings of the parent corporation for the year in which the liquidation occurred. The transfer of an operating deficit would necessarily result in the same manner, that is, in the reduction of the earnings for the current taxable year. Thus earnings or operating deficits of the subsidiary for prior years are obviously not prior years' earnings or operating deficits of the parent, but upon transfer on the dissolution of the subsidiary become current earnings or operating deficits of the parent. As stated heretofore, all transactions necessarily affect the earnings of the year in which they occur. To hold otherwise in the case of the transfer of a subsidiary's earnings or operating deficits results in a disregard of the corporate entity, since the only possible alternative is to segregate the earnings and losses of the subsidiary into the respective years in which they occurred and assume a corresponding effect upon the earnings of the parent. Such a disregard of the separate corporate entities is not supported by any authority.

III.

THE GOVERNMENT ERRS IN REDUCING THE LOSS SUSTAINED BY HONOLULU UPON THE LIQUIDATION OF ITS SUBSIDIARIES BY THE AMOUNT OF THE SUBSIDIARIES' OPERATING LOSSES WHICH WERE AVAILED OF ON CONSOLIDATED RETURNS.

On page 15 of its brief the Government advances the argument that the amount of the loss sustained by Honolulu upon the liquidation of its subsidiaries must be reduced by the amount of $694,151.15, representing the amount of the subsidiaries' operating losses availed of to reduce the taxable income of the affiliated group in the years 1928 to 1932, inclusive. It is true that in order to prevent a double deduction for the purpose of determining *Honolulu's income taxes,* Honolulu's investment in the stock of its subsidiaries must be reduced by the amount of the losses of the subsidiaries which were utilized on a consolidated return to reduce Honolulu's income which would otherwise have been subject to tax. This means that in the event Honolulu had sold the stock of its subsidiaries or had attempted for tax purposes to deduct the loss on liquidation, its cost would have to be reduced by the amount of $694,151.15 in order to prevent a double deduction by Honolulu. However, the *earnings available for dividends* by Honolulu were not affected by the fact that it filed a consolidated return with its subsidiaries for income tax purposes. In so far as the determination of earnings available for dividends is concerned, Honolulu's cost remains unaffected by the fact that consolidated returns had been filed for tax purposes, and no part of the losses of the subsidiaries can reduce the

earnings of Honolulu, without completely disregarding the separate corporate entities, until the full loss is realized on ultimate liquidation. There is thus no double deduction. It is only in the determination of statutory net income for tax purposes that the basis of the stock of the subsidiaries to Honolulu is not their actual cost. The distinction between statutory net income and earnings available for dividends is fully set forth in subdivision II(a) of appellant's opening brief and need not be repeated here. The Government has evidently confused the determination of net income for tax purposes with the determination of earnings or profits available for dividends.

IV.

THE ATTEMPTED RETROACTIVE APPLICATION OF SECTION 501 OF THE SECOND REVENUE ACT OF 1940 VIOLATES THE DUE PROCESS CLAUSE OF THE CONSTITUTION.

The cases cited by the Government (Br. p. 19) in support of its argument that the retroactive application of section 501 of the Second Revenue Act of 1940 is not unconstitutional are readily distinguishable from the instant case. In *United States v. Hudson,* 299 U. S. 498, the statute upheld as constitutional had been made retroactive for a period of thirty-five days. In *Cooper v. United States,* 280 U. S. 409, and *Martz v. Commissioner,* 82 F. (2d) 110 (C.C.A. 9), the provisions upheld as constitutional had been given retroactive effect only to the beginning of the calendar year in which the statutes were enacted. The situation existing in the case of *Wilgard Realty Co. v. Commissioner,*

127 F. (2d) 514 (C.C.A. 2), clearly justified the retroactive application of the statute as pointed out in appellant's opening brief. The same statutory provision was involved in *Commissioner v. Corpus Christi Terminal Co.,* 126 F. (2d) 898 (C.C.A. 5), and *D. W. Klein Co. v. Commissioner,* 123 F. (2d) 871 (C.C.A. 7), but the constitutional question was not discussed in either case.

In *Welch v. Henry,* 305 U. S. 134, relied upon by the Government, a Wisconsin statute enacted in 1935 was upheld as constitutional, although it was given retroactive effect to 1933. After referring to the cases upholding income tax statutes given retroactive effect for the year of the session in which the taxing statute is enacted, and in some instances during the year of the preceding session, the Supreme Court upheld the Wisconsin statute on the ground that the regular session of the Wisconsin Legislature which preceded the enactment of the statute was the 1933 session. The Court said:

> "And we think that the 'recent transactions' to which this Court has declared a tax law may be retroactively applied, Cooper v. United States, 280 U. S. 409, 411, 50 S. Ct. 164, 74 L. Ed. 516, must be taken to include the receipt of income *during the year of the legislative session preceding that of its enactment.* (Italics added.)
>
> * * * * * * *
>
> While the Supreme Court of Wisconsin, 223 Wis. 319, 271 N. W. 68, 72, thought that the present tax might 'approach or reach the limit of permissible retroactivity', we cannot say that it exceeds it."

The Government also refers (Br. p. 20) to the decision of the Tax Court of the United States in *Estate of John H. Wheeler v. Commissioner,* 1 T. C. 640, now pending before this Court. This case holds that the retroactive application of section 501 of the Second Revenue Act of 1940 to transactions occurring in 1938 is not unconstitutional. That case is distinguishable from the instant case not only because of the shorter period of retroactivity—two years as compared with four years—but also because the Tax Court felt that the particular facts justified the retroactive application of the statute. Thus the Tax Court said, pages 651-652:

> "It cannot be said that the application of the provisions of section 501(a) to section 112(b)(7) results in a harsh tax, since the gain recognizable thereunder is substantially less than the amount of gain which would have been taxable under section 115(c) * * *. The petitioners elected to be taxed under section 112(b)(7) and they cannot complain if such election resulted in a greater tax than they expected to pay * * *. As pointed out above, applying section 501(a) to section 112(b)(7), the gain recognizable was less than it would have been under section 115(c), so that the petitioners were benefited to that extent at least."

CONCLUSION.

The simple facts of this case are that Honolulu incorporated three subsidiaries to carry on operations in other states, that these subsidiaries operated at a loss and were liquidated, at which time Honolulu itself

realized the loss resulting from these ventures. The Government insists that this loss actually realized by Honolulu does not reduce earnings available for dividends, although it admits that if there had been a profit the earnings of Honolulu would have been increased by a transfer of the earnings of its subsidiaries. The Government apparently concedes that this result is highly illogical. It is also inequitable. Unless the statute compels such a result, logic and equity require a decision for the appellant. The statute does not require such a result if it is held that the operating deficits of the subsidiaries were absorbed by Honolulu. It is only by so holding that section 501 of the Second Revenue Act of 1940 operates equitably and its retroactive application to all prior Revenue Acts can be justified, as intended by Congress, "as but another aspect of the principle" of the *Sansome* case.

Dated, San Francisco,
April 6, 1944.

Respectfully submitted,
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(Appendix Follows.)

Appendix.

Appendix

REVENUE ACT OF 1936.

Sec. 115. Distributions by Corporations. (49 Stat. 1682.)

(c) Distribution in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as a full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as a part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117(a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a

distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.